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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, DECEMBER 21, 2000

APPLICATION OF

VERIZON SOUTH INC.

CASE NO. PUC000265

For approval of its
Plan for Alternative Regulation

ORDER APPROVING PLAN

On October 2, 2000, Verizon South Inc. ("Verizon South" or "Company") filed the above-captioned application with the State Corporation Commission ("Commission"). The Company requested the Commission approve a Plan for Alternative Regulation ("Plan") for the Company that employs a price indexing mechanism similar to those previously approved for Verizon Virginia Inc. and the Sprint local exchange telecommunications companies, United Telephone-Southeast, Inc. and Central Telephone Company of Virginia.

Verizon South asserted that its proposed Plan, which it attached to its motion, met the statutory requirements for approval and was in the public interest. The Company represented that it worked extensively with the Staff of the Commission to develop the Plan.

The Plan's major provisions cap prices for Verizon South's basic local exchange telecommunications services to January 1,

2004, and permit (but not require) increases to these services at no more than one half the change in the Gross Domestic Product Price Index thereafter. For services classified as discretionary, price increases would be limited to no more than 10% per year. The Plan also provides that no price increases will be permitted unless Verizon South is meeting Commission standards for service quality and reliability.

On October 18, 2000, we issued our Order for Notice and Comment inviting interested parties to file comments or requests for hearing on the application. Comments, but not requests for hearing, were received from the Office of Attorney General, Division of Consumer Counsel ("Consumer Counsel") and AT&T Communications of Virginia, Inc. ("AT&T").

Neither Consumer Counsel nor AT&T opposed the adoption of the proposed Plan, though AT&T noted that it contained features comparable to those that AT&T found objectionable when similar plans were adopted in Case No. PUC930036 for Bell Atlantic-Virginia and the Sprint companies.¹ These include the mechanism whereby revenue-neutral changes may be made in rates; an alleged deficiency in the productivity sharing mechanism; and the

¹ Commonwealth of Virginia ex rel. State Corporation Commission, Ex parte: In the matter of investigating telephone regulatory methods pursuant to Virginia Code § 56-235.5, etc., 1994 S.C.C. Ann. Rep. 262 (Final Order, October 18, 1994).

failure of the Plan adequately to prevent subsidization of competitive services with revenues from monopoly services.

Consumer Counsel opined that we should convene a "going-in" rate case for Verizon South, or else "evaluate – before approving the plan – whether the going-in rates are appropriate and do not harm consumers" on the basis of evidence to be taken at a hearing. Consumer Counsel also requested that we expressly recognize, if problems with the Plan arise, that we will issue notice and convene a hearing pursuant to Code § 56-235.5 D "to determine if [the] alternative plan is failing to meet legal requirements or expectations."

NOW THE COMMISSION, upon consideration of the application, the comments thereto, and the applicable statutes and rules finds that the Plan as proposed should be adopted and approved for use by Verizon South on and after January 1, 2001.

We have examined the revenues of the Company annually since it entered its current Plan of Alternative Regulation on January 1, 1995, through the mechanism of its annual informational filings ("AIFs"). On Friday, December 15, 2000, we approved a \$200 million refund to the Company's customers based on a settlement negotiated between our Staff, Consumer Counsel, AT&T, and the Company, resolving all issues in each AIF

case that remained pending.² Since it entered its original alternative regulatory plan, GTE South (as the Company was then known) has also undergone one comprehensive general rate case,³ which resulted in approximately \$27 million in rate reductions.

Late last year, we approved the merger of Bell Atlantic Corporation and GTE Corporation, the parent companies of, respectively, the entities now known as Verizon Virginia Inc. and Verizon South Inc.⁴ Due to conditions imposed by the Commission on the merger, Verizon South will experience certain reductions to its revenues as a result of the expansion of local calling areas for many of its customers and from adjustments to rates in its former Southwest operating territory to align those customers' rates with those paid by similarly situated customers in the rest of the newly merged company. These two changes will, in our analysis, lower the Company's revenues by approximately \$15.5 million on an annual basis. Additionally, the Company has agreed to advance the deployment of certain

² Application of Verizon South Inc., Annual Informational Filings, Case Nos. PUC960134, PUC970071, PUC970072, PUC980098, PUC990121, PUC000192, PUC000266 (Order Approving Joint Agreement and Requiring Refund, December 15, 2000).

³ Application of GTE South Incorporated, For revisions to its local exchange, access, and intraLATA long distance rates, Case No. PUC950019, 1997 S.C.C. Ann Rep. 216 (Order, August 7, 1997), aff'd sub. nom. GTE South Incorporated v. AT&T Communications of Virginia, Inc. et al., 259 Va. 338, 527 S.E.2d 437 (March 3, 2000).

⁴ Joint Petition of Bell Atlantic Corporation and GTE Corporation For Approval of Agreement and Plan of Merger, Case No. PUC990100 (Final Order, November 29, 1999)

enhanced network features in its service area. Specifically, it will make its Customer Local Area Signaling Services available to all customers within 24 months after the merger and, further, the Company agreed to specific annual minimum levels of plant investment in Virginia in years 2000-02.

Finally, earlier this month we approved a negotiated reduction in Verizon South's access revenues.⁵ As a result of this action, the Company will experience a cumulative revenue reduction over a five-year period of more than \$100 million. The initial rate reductions effective January 1, 2001, will reduce the Company's access charge revenues by approximately \$6 million in that year. Further rate reductions will be implemented for each of the next four years thereafter. At the end of the 5th year, access revenues will be approximately \$36 million lower than they are today.

We recite these facts to demonstrate both that the Company's rates have been re-established through a general rate proceeding to just and reasonable levels subsequent to its entry into its current Plan of Alternative Regulation and that its rates have been substantially reduced further by succeeding regulatory actions. We have analyzed the effect of these

⁵ Commonwealth of Virginia ex rel. State Corporation Commission, Ex parte, In re: Investigation of the appropriate level of intrastate access service prices of Verizon South Inc., Case No. PUC000283, D.C.C. No. 001210230 (Final Order, December 7, 2000).

reductions and are satisfied that given the reductions over the next five years, the rates and price increase provisions of the Plan should be appropriate for the foreseeable future.

We are not persuaded by AT&T's specific criticisms of the proposed plan, which in large measure restate its objections to the original price cap plans. There are factors in the current circumstances and in Verizon South's Plan that do not appear in the Verizon Virginia and Sprint plans and which are refinements to these original price cap plans. Foremost is the agreement by the Company that it will not be eligible for any rate adjustment unless it is meeting all service quality rules now or hereafter promulgated. AT&T asserts that the price change mechanism in the Plan does not allow customers to share in decreasing costs from all productivity gains. While true, the cumulative access charge reductions over the next several years serve to offset the potential enhancement to the Company's revenues from the "productivity" mechanism.

With respect to the "revenue-neutral" price change mechanism, we note that there have been only two instances when Verizon Virginia or the Sprint companies have successfully used this feature of their Plans. The inclusion of the specific language in Paragraph R of the Plan to forbid inclusion of access prices in any revenue-neutral change is a positive refinement as well. We find that the Plan meets all the

requirements set forth in § 56-235.5 of the Code of Virginia and its adoption is in the public interest.

Accordingly, IT IS THEREFORE ORDERED THAT:

(1) The Verizon South Inc. Plan for Alternative Regulation attached hereto is approved and shall be effective as of January 1, 2001.

(2) Verizon South shall notify the Commission, by letter addressed to the Director of the Division of Communications, of any election to adopt the Plan approved herein not later than five (5) days prior to its proposed implementation date.

(3) There being nothing further to come before the Commission in this case, this matter is dismissed.